

## Message Text

CONFIDENTIAL

PAGE 01 STATE 309075  
ORIGIN TRSE-00

INFO OCT-01 EUR-12 ISO-00 EB-08 AID-05 IGA-02 CIAE-00  
COME-00 FRB-03 INR-07 NSAE-00 USIA-06 XMB-02  
OPIC-03 SP-02 LAB-04 SIL-01 OMB-01 SS-15 L-03  
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FM SECSTATE WASHDC  
TO AMEMBASSY LISBON

C O N F I D E N T I A L STATE 309075

E.O. 11652: GDS

TAGS: ECON, EFIN, PO

SUBJECT: GOP/IMF NEGOTIATIONS

REFS: A) LISBON 9547; B) LISBON 9574; C) LISBON 9637

1. APPRECIATE EMBASSY'S ANALYSIS OF GOP/IMF POSITIONS  
FOR A STANDBY AGREEMENT. WE ARE PARTICULARLY PLEASED  
TO NOTE PUBLIC RECOGNITION THAT THE ECONOMIC CRISIS STEMS  
FROM PORTUGAL'S DIFFICULTIES IN DEALING WITH ITS ECONOMIC  
PROBLEMS RATHER THAN FROM IMF PROPOSALS.

2. THE IMF STAFF HAS INFORMED US THAT THEY ARE MAIN-  
TAINING CLOSE CONTACT WITH GOP OFFICIALS SO AS TO BE IN  
A POSITION TO BEGIN NEGOTIATIONS AT THE EARLIEST POSSIBLE  
DATE. GOVERNOR SILVA LOPES, FOR EXAMPLE, IS IN REGULAR  
TELEPHONE COMMUNICATIONS WITH THE FUND STAFF.

CONFIDENTIAL

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PAGE 02 STATE 309075

3. OUR SPECIFIC REACTIONS TO YOUR ANALYSIS FOLLOW:

A) WE AGREE THAT THE MOST CONTENTIOUS ISSUE IN THE STAND-  
BY PROPOSAL IS THE INTEREST RATE QUESTION. THE ABILITY  
OF THE GOP TO DEAL WITH ITS ECONOMIC PROBLEMS WILL BE  
MOST CLEARLY EVIDENT IN DEALING WITH THIS QUESTION.

B) YOU CONCLUDE THAT ACHIEVEMENT OF THE \$800 MILLION CURRENT ACCOUNT DEFICIT TARGET IS INCOMPATIBLE WITH A 4 PERCENT GNP GROWTH. WITH A 6 PERCENT DECLINE IN IMPORTS FROM 1977 YOU ASSUME THAT THE ECONOMY CANNOT GROW BY MORE THAN APPROXIMATELY 1 PERCENT. WHILE THERE IS SCOPE FOR DIFFERENT VIEWS ABOUT THE RELATIONSHIP BETWEEN A SPECIFIC CURRENT ACCOUNT DEFICIT AND A GNP GROWTH TARGET, IT DOES NOT SEEM REASONABLE TO ASSUME A FIXED RELATIONSHIP IN THE PRESENT CIRCUMSTANCES IN PORTUGAL. THE RAPID INCREASE IN THE MONETARY AGGREGATES DURING 1977, WHICH IS VERY PROBABLY ASSOCIATED WITH AN INVENTORY ACCUMULATION, WOULD, FOR EXAMPLE, THROW A NEW VARIABLE INTO THE PICTURE. TO THE EXTENT THERE HAS BEEN AN INVENTORY ACCUMULATION, THE IMPORT NEEDS OF THE ECONOMY COULD BE MET BY A DRAWDOWN IN STOCKS. ALSO IMPORTANT COULD BE A RE-ORIENTATION AWAY FROM IMPORT INTENSIVE INVESTMENT.

4. THE IMF STAFF ADVISED US THAT THEY HAD OUTLINED THEIR PROPOSED PROGRAM FOR PORTUGAL IN AN AIDE MEMOIRE OF OCTOBER 30, 1977, ENTITLED "STABILIZATION PROGRAM FOR PORTUGAL" A COPY OF WHICH YOU MAY WISH TO REQUEST FROM THE PORTUGUESE. IN THIS PAPER THE FUND OUTLINED THREE ALTERNATIVE STRATEGIES: (A) CONTINUATION OF PRESENT POLICIES; (B) CONTAINMENT OF DOMESTIC ECONOMY WITH A FIXED EXCHANGE RATE AND (C) COMBINATION OF EXCHANGE RATE CHANGE  
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PAGE 03 STATE 309075

AND DOMESTIC RESTRAINT. STRATEGY A IS CLEARLY UNTENABLE GIVEN THE PORTUGUESE INABILITY TO FINANCE A CONTINUING CURRENT ACCOUNT DEFICIT OF \$1.2 BILLION. THE DEGREE OF DOMESTIC CONTRACTION WHICH WOULD BE REQUIRED UNDER STRATEGY B IS CLEARLY NOT ECONOMICALLY OR POLITICALLY ACCEPTABLE. THE ONLY VIABLE ALTERNATIVE IS A BALANCED COMBINATION OF EXCHANGE RATE DEPRECIATION AND DOMESTIC CREDIT CONSTRAINT. THE SPECIFICS OF THIS STRATEGY, WE ALL RECOGNIZE, ARE NEGOTIABLE BETWEEN THE GOP AND THE IMF.

5. THE PROPOSED STRATEGY CAN BE IMPLEMENTED WITH VARYING DEGREES OF MOVEMENTS IN EXCHANGE RATES AND DOMESTIC CREDIT CONSTRAINTS. WITH TIGHTER DOMESTIC CREDIT THE RATE OF DEVALUATION WOULD BE SMALLER. IF FOR POLITICAL OR ECONOMIC REASONS DOMESTIC CREDIT CANNOT BE RESTRICTED OR INTEREST RATES INCREASED, THE DEVALUATION WILL HAVE TO BE GREATER. THE FUND OBJECTIVE IS TO ACHIEVE SUFFICIENT DOMESTIC CREDIT RESTRAINT TO GET SOME IMPROVEMENT IN THE BALANCE OF PAYMENTS WITHOUT THE NEED FOR AN OVERWHELMING DEVALUATION.

6. THE EMBASSY ANALYSIS EMPHASIZES THE POLITICAL CON-

STRAINTS ON INTEREST RATE HIKES AND SUGGESTS GREATER

DEVALUATION. THE GOP IS LIKELY TO ARGUE ITS OWN POLITICAL  
CASE VERY FORCEFULLY. AT THIS STAGE OUR POSTURE SHOULD  
BE ONE OF NEUTRALITY. VANCE

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## Message Attributes

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